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UNCLAS SECTION 01 OF 03 HARARE 000338

SIPDIS

SENSITIVE

STATE FOR AF/S AND AF/EX
NSC FOR SENIOR AFRICA DIRECTOR JFRAZER
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PASS USTR ROSA WHITAKER
TREASURY FOR ED BARBER AND C WILKINSON
STATE PASS TO USAID FOR MARJORIE COPSON

¶E. O. 12958: N/A
TAGS: ETRD EFIN ECON ZI
SUBJECT: Reviving a post-Mugabe Economy

Ref: 02 Harare 2700

¶1. (SBU) Summary: A future GOZ may have to summon Herculean might to resurrect the world's fastest shrinking economy. It will have to downsize its bureaucracy, "reform" land reform, secure international financing and devalue the Zimdollar by at least 80 percent. Then it will have to wean its population from negative borrowing rates, dirt-cheap fuel and donated food. Worse still, the later a new GOZ gets started, the more arduous -- and eventually, futile -- its task. End Summary.

The Present Quandary

¶2. (U) The Mugabe government's neo-Marxist approach to economics has dug the country into an ever-deepening pit. Since the GOZ bid farewell to fiscal policy and awarded 50,000 so-called War Veterans about US$ 2,800 each in 1997, its economic policies have become downright surreal. At present, fuel costs less than US$.20/gallon. The official exchange rate is 4 percent of the market rate. Amateurs continue to supplant professional farmers. Holders of Treasury Bills earn minus 161 percent interest while banks lend money at minus 144 percent (using conservative official inflation rates). Exports often carry nearly 100 percent tax-rates. And retail prices are controlled at below-production cost on nearly every staple.

¶3. (U) As a result, a small number of Zimbabweans have gotten wealthy and the rest poor. The country's GDP has lost about 35 percent in real terms. Businesses are closing. There is almost no foreign investment.

¶4. (SBU) Dazed Zimbabweans are only beginning to come to grips with their impoverishment. In an abstract way, they blame a "shortage of foreign exchange" for high import prices. The real problem is, of course, Zimbabwe's diminished capacity to produce value for the world economy. But the unsupported and fictitious official rate, along with runaway inflation, obscures this reality. When a future GOZ finally recognizes the parallel rate, most Zimbabweans -- who earn less than US$ 20/month -- will finally appreciate that their bloated Zimdollar salaries are a smokescreen, and how little buying power they now have in the international marketplace. For those who remember earning US$ 100-150/month several years ago, this will come as a jolt.

Managing the Transition

¶5. (SBU) How does any government clean up this mess? In seeking answers, purely hypothetical at the moment, we discussed Zimbabwe's economic future with local economists, politicians, lenders and businessmen. Most analysts envision two enormous hurdles awaiting a reform-minded GOZ: economic stabilization and land redistribution. An amalgamation of their views follows.

¶6. (SBU) First, a caveat: It will become progressively more difficult to undo the damage. If the economy started growing at 4 percent annually this year, it might take 7 years to regain 1998 prowess. After 3 more years of steep decline, it could take a full generation of uninterrupted robust growth, or 2 generations of slow growth. Zimbabwe's infrastructure -- education, railway, energy, etc. -- is crumbling, but still largely intact. This may no longer be the case after another 3 years of the present policies. At the same time, about 1,000 of 4,500 white farmers are still on their land in some form (although most are not farming) and many others are living here in limbo. At some point, they permanently depart the scene and a potential resource is lost.

First Hurdle: Regain Fiscal & Monetary Control

¶7. (SBU) The GOZ would have to enact a stabilization plan that attacks fiscal, exchange rate and monetary problems. On the fiscal side, it could reduce ministries from 29 to 12, as the opposition Movement for Democratic Change (MDC) proposes, with minimal drop in public service. It could also replace a costly fuel subsidy (about 7 percent of GDP if demand were fully satisfied) with more targeted support for public transport and essential services. For revenue, there is little room to increase already high tax rates, but economic reinvigoration could also eventually boost tax receipts. The GOZ could apply several one-time measures, such as privatization of inefficient parastatals, as transitional revenue tools.

¶8. (SBU) The GOZ's fiscal indiscipline has led to a loose, print-and-spend monetary policy. More than any other policy, seigniorage has caused inflation in the 300-400 percent vicinity. When the government gradually stops crowding out borrowing by the private sector, firms will probably respond by increasing investment. After a significant and inevitable time-lag, this should propel Zimbabwe down a sustainable growth path.

¶9. (SBU) Obviously, the GOZ will need to rethink its exchange rate regime. A market rate that eclipses the official rate by 25-fold has destroyed exporters. Analysts feel that switching to a floating rate would have minimal negative consequences, since the economy already tacitly runs on the market rate. International backing and a primary (non-interest) surplus, as soon as is manageable, could help rein in a runaway currency and make sure a new exchange rate is sustainable.

¶10. (SBU) Outside assistance would also have to cushion the blow of escalating prices and borrowing rates. It would have to For the International Monetary Fund (IMF) to consider new loans, Zimbabwe would have to clear its unserviced debt. Bilateral donors, such the U.S., could offer a bridge loan (in effect, a bail-out) to cover arrears, freeing the IMF as well as the World Bank to consider new packages. With arrears up to around US$ 1.7 billion, this comes neither cheap nor risk-free but it may be preferable to perpetual food aid.

Second Hurdle: Rationalize Land Reform

¶11. (SBU) A new GOZ would have to revamp fast-track land reform, although any policy change would disrupt hundred-of-thousands of Zimbabweans with assorted interests. We have estimated, for example, that 300,000 - 500,000 farm workers have lost homes/jobs while the GOZ has resettled perhaps 150,000 new farmers (it claims 350,000). Meanwhile, only 600 of 4,500 white commercial farmers are still attempting to produce something (ref). More complicated still, politically-connected Zimbabweans who have seized large farms will resist turning back their bounty. However, if a future GOZ does not address this critical issue, it stands little chance of restoring the agricultural sector. New farmers are failing under the present model. The U.S. and other Western countries will be more apt to provide bail-out loans or even aid to new farmers if the GOZ resolves outstanding claims and restores the concept of title.

¶12. (SBU) In spite of the hopes of white farmer groups, a wing of the MDC and many ordinary Zimbabweans, it is unlikely that a GOZ could completely undo land reform. More probably, a new GOZ could try to return white farmers to their houses and land if they relinquish a portion of it and provide assistance to new farmers. Some observers suggest the new GOZ could evict A2 (commercial) but not A1 (small-scale) farmers, or make new land available with better support in another area. Other observers would like to see the GOZ make a distinction between white farmers who own single or multiple farms, or who acquired land before or after independence. Admittedly, evicting some settlers from farmhouses and the surrounding land would be an unpleasant, divisive and risky move -- and one not available for long. In another two years, new farmers will be more physically and emotionally attached to the land while many white farmers will no longer reside in Zimbabwe. At that point, the GOZ will have to live with costly compensation claims hanging over its head.

Comment

¶13. (SBU) If a GOZ successfully turns around the economy and land reform, other benefits will follow. No longer punished by oppressive exchange and tax regimes, the export sector could boom, assisted, perhaps, by Zimbabwe's qualification for the African Growth and Opportunity Act (AGOA). While such policies could revive agriculture, mining and manufacturing, they may open the way for Zimbabwe to finally cash in on a potentially more lucrative sector: tourism.

¶14. (SBU) But this is the rosiest outcome. It is possible that a ZANU-PF government will follow the same policy drift for several more years or even expand forced indigenization to industry or residential housing. When the dust settles, Zimbabwe will be an economic basket-case, a shell of its former self. Even if a reform-minded government comes to power, it is far from certain that new leaders will have the political will and skill to guide the population through the bruising and tumultuous transition period we describe above. In any event, we believe the U.S. should be ready to assist if a post-Mugabe GOZ braves this thorny path.

Sullivan